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• Section 285.305

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# **Consumers Water Company and Associated Companies**

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*Postretirement Benefit Valuation Report  
for Determination of  
Maximum Tax Deductible Contribution  
under the 501(c)(9) Trust (VEBA)  
for the Fiscal and Taxable Year Beginning  
January 1, 1999*

November 18, 1999

*Prepared by:*

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## Highlights

This report has been prepared by William M. Mercer for the Consumers Water Company and Associated Companies. The purpose of this report is to:

- Present the results of the 501(c)(9) contribution analysis of the Union and Non-Union retiree life insurance and medical plans for Consumers Water Company and Associated Companies for the 1999 tax year;
- Provide to the plan sponsor the maximum tax-deductible contributions to the VEBAs for the year beginning January 1, 1999; and
- Provide reporting information for governmental agencies and other interested parties.

### Maximum Tax Deductible Contribution

The preliminary range of contributions for the year, with all subsidiaries aggregated, is as follows:

Annual Contribution	Union	Non-Union			Total
		Life	Medical	Subtotal	
Minimum Contribution *	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Maximum Contribution	\$ 2,159,482	\$ 69,947	\$ 179,710	\$ 249,657	\$ 2,409,139

Note that the non-union subtotal and the grand total shown are for illustrative purposes only. Actual deductible limits and asset maintenance are strictly determined within the union, non-union medical, and non-union life insurance subaccounts of the VEBA. No transfer of funds between these accounts is permissible.

These are the figures shown on the table on page 6 of this report. For the non-union medical and non-union life subaccounts, the increase in reserve and the estimated 1999 benefit payments and expenses are included, but after-tax income on non-union life subaccount investments has not yet been subtracted.

\* Currently, there are no minimum funding requirements for postretirement benefits other than pensions.

## **Summary**

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Section 501(c)(9) of the Internal Revenue Code specifies that a Voluntary Employees' Beneficiary Association (VEBA) may provide for the payment of life, sick, accident or other benefits to the members of the VEBA or their dependents or designated beneficiaries.

### **Qualified Cost**

The Internal Revenue Code allows a tax-deductible contribution for qualified direct costs as well as an addition to the qualified asset account for a postretirement medical and life benefits reserve funded over the working lives of the covered employees. The expected future working lifetimes of covered employees are determined using the actuarial assumptions shown in the Actuarial Basis of this report on page 7.

### **Qualified Direct Cost**

IRC §419(c) defined the term qualified direct cost to mean the aggregate amount (including administrative expenses) which would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year, if such benefits were provided directly by the employer, and the employer used the cash receipts and disbursements method of accounting. In the year in which the VEBA is established, benefit payments and expenses will likely be paid outside the VEBA and are not deductible as contributions to the VEBA.

### **Addition to Qualified Asset Account (Increase in Reserve)**

IRC §419A(c) specifies that the account limit for any taxable year may include a reserve funded over the working lives of the covered employees, actuarially determined on a level basis. Liabilities for non-bargained benefits must be determined on the basis of current medical costs (i.e., no medical trend assumed).

### **Key Employees**

It has been agreed that the key employees are to be excluded from the calculation of liabilities for use in the determination of the contribution limitations for the account and, thus, all the amounts developed for this study exclude key employees. Inclusion of any key employees could result in unfavorable tax consequences. Key employees are those as defined by IRC §416(i). The excluded key employees, as provided to Mercer by Consumers Water Company and Associated Companies, are Bob Ervin and Jerry Snellen.

### **Funding**

Consumers Water Company and Associated Companies has opted to pre-fund all bargained and non-bargained retiree medical and life benefits through separate subaccounts maintained in a VEBA trust. The benefits funded through the VEBA trust are medical and life benefits for all retirees excluding key employees.

## Summary (cont'd)

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The Code does not specify any minimum funding requirements. While it is generally accepted that this means the minimum contribution is \$0, there has been one recent court case that developed the position that Congress intended that deductibility of contributions be predicated on the permanency of prefunding (i.e., not permitting funding one year with a total draw-down the next year).

The Code does specify maximum tax-deductible contributions. Generally, the maximum contribution in any tax year is the qualified cost less any fund income (which includes the fund's after-tax income and any contributions made by members, their dependents or designated beneficiaries for the taxable year).

Investment gains realized during the year reduce the allowable contribution. However, overfunding does not result in a penalty but rather a deferral of the tax deduction.

Since non-union medical and life benefits are treated differently for tax purposes, separate subaccounts must be maintained in the VEBA.

### Timing

Contributions to the 501(c)(9) trust must be made *within the employer's taxable year* in order for the contribution to be deductible currently.

### Investment Income

Investment income is a reduction to the tax-deductible contribution limit for the year. Furthermore, IRC §5.12(a) specifies that investment income with respect to retiree medical reserves is subject to Unrelated Business Income Tax (UBIT). However, income on reserves for all bargained benefits and non-bargained retiree life insurance benefits would not be taxable for UBIT purposes.

### Estimates and Margin

Many of the figures used to develop the maximum contribution are estimates (such as fund income, current year benefit payments, and related administrative expenses). Accordingly, Consumers Water Company and Associated Companies may wish to contribute something less than the maximum in order to protect against overcontributing.

## Certification

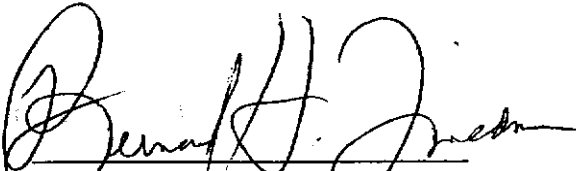
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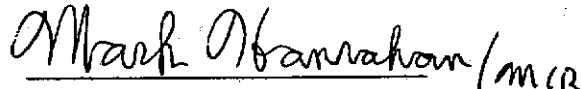
We have prepared an actuarial valuation of the 501(c)(9) provisions of the plan for the plan year beginning January 1, 1999, and ending December 31, 1999. The purpose of this valuation was to determine the maximum deductible contribution under IRC §419 and IRC §419A for the taxable year ending December 31, 1999. The results of the valuation are set forth in this report, which reflects the provisions of plans as effective January 1, 1999.

The valuation is based on employee and financial data which were provided by Consumers Water Company and which are summarized in this report. We have reviewed the employee and financial data for reasonableness but have not completed an audit of this information.

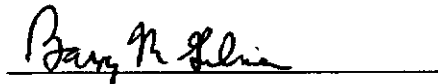
All costs, liabilities and other factors under the plan were determined in accordance with generally accepted actuarial principles and procedures, in accordance with the provisions of current Federal statutes and regulations issued thereunder, using an actuarial cost method which we believe is appropriate. In our opinion, the actuarial assumptions are reasonable and represent our best estimate of the anticipated experience under the plan, other than the legally mandated assumption of no future increase in health care cost levels.

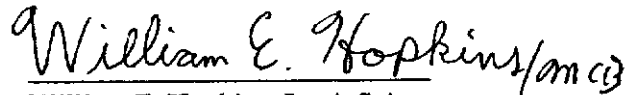
We are available to answer any questions on the material contained in the report, or to provide explanations or further details as may be appropriate.

  
Bernard H. Friedman, A.S.A., E.A.  
(617) 450-6639

  
Mark Hanrahan, F.S.A.  
(203) 973-2104

The undersigned has reviewed and found acceptable the actuarial assumptions, methods, and procedures used in preparing this actuarial valuation.

  
Barry M. Gilman, F.S.A.  
(617) 450-6333

  
William E. Hopkins, Jr., A.S.A.  
(609) 520-3708

**Consumers Water Company**  
**1/1/1999 LIABILITIES AND ASSETS**  
**ALLOCATED BY SUBSIDIARY**

<u>Subsidiary</u>	<u>Union</u>		<u>Non-Union</u>						<u>Grand Total</u>	
	<u>EPBO</u>	<u>MV</u>	<u>Life</u>		<u>Medical</u>		<u>Total</u>		<u>EPBO</u>	<u>MV</u>
			<u>EPBO</u>	<u>MV</u>	<u>EPBO</u>	<u>MV</u>	<u>EPBO</u>	<u>MV</u>		
Consumers New Hampshire Water Company	-	-	7,152	-	28,261	12	35,413	12	35,413	12
Consumers Information Services Group	-	-	9,743	-	26,886	-	36,629	-	36,629	-
Consumers Service Company Group	-	-	32,948	-	91,519	-	124,467	-	124,467	-
Consumers Water Company (Other)	-	-	54,053	-	68,920	-	122,973	-	122,973	-
Consumers New Jersey Water Company	-	-	81,363	9,876	191,014	19,672	272,377	29,548	272,377	29,548
Consumers Illinois Water Company	443,788	78,014	88,591	29,542	309,422	67,060	398,013	96,602	841,801	174,616
Consumers Maine Water Company	-	-	67,948	13,219	171,404	32,679	239,352	45,898	239,352	45,898
Consumers Ohio Water Company	942,054	162,322	117,311	32,030	244,865	56,346	362,176	88,376	1,304,230	250,698
Consumers Penn. - Susquehanna Division	27,513	10,934	9,399	1,720	69,155	3,688	78,554	5,408	106,067	16,342
Consumers Penn. - Roaring Creek Division	189,774	22,286	39,173	7,170	122,845	6,550	162,018	13,720	351,792	36,006
Consumers Penn. - Shenango Valley Division	781,984	50,668	72,799	13,325	356,492	19,009	429,291	32,334	1,211,275	83,002
<b>TOTAL</b>	<b>2,385,113</b>	<b>324,224</b>	<b>580,480</b>	<b>106,882</b>	<b>1,680,783</b>	<b>205,016</b>	<b>2,261,263</b>	<b>311,898</b>	<b>4,646,376</b>	<b>636,122</b>



**Consumers Water Company  
1999 VEBA DEDUCTIBLE LIMITS AND  
1999 NET PERIODIC POSTRETIREMENT BENEFIT COST  
ALLOCATED BY SUBSIDIARY**

	Union VEBA Deduction	Non-Union			Ben. Pymts & Expenses **	Non-Union Total	Grand Total	1999 Net Periodic Postretirement Benefit Cost
		VEBA Deduction*		Sub-Total				
		Life	Medical					
Consumers New Hampshire Water Company	-	0	0	0	1,760	1,760	1,760	6,100
Consumers Information Services Group	-	1,464	3,145	4,609	-	4,609	4,609	3,800
Consumers Service Company Group	-	5,500	12,116	17,616	-	17,616	17,616	11,700
Consumers Water Company (Other)	-	0	0	0	7,084	7,084	7,084	13,600
Consumers New Jersey Water Company	-	11,069	18,145	29,214	3,288	32,502	32,502	22,600
Consumers Illinois Water Company	370,360	8,647	12,570	21,217	16,992	38,209	408,569	83,800
Consumers Maine Water Company	-	12,258	15,733	27,991	1,798	29,789	29,789	21,000
Consumers Ohio Water Company	817,112	12,400	9,008	21,408	13,835	35,243	852,355	140,200
Consumers Penn. - Susquehanna Division	17,089	1,033	4,829	5,862	2,628	8,490	25,579	16,400
Consumers Penn. - Roaring Creek Division	181,622	4,846	7,285	12,131	7,949	20,080	201,702	35,100
Consumers Penn. - Shenango Valley Division	773,299	9,334	21,890	31,224	23,051	54,275	827,574	124,600
TOTAL	2,159,482	66,551	104,721	171,272	78,385	249,657	2,409,139	478,900

\* Increase in reserve.

\*\* Estimated 1999 benefit payments and expenses, which are deductible as a contribution to the VEBA. Of the total, \$3,396 is attributable to life insurance benefits and \$74,989 is attributable to medical benefits. After-tax income on investments, up to December 31, 1999, will have to be subtracted from the amounts shown.

## Actuarial Basis

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Attribution Method	Projected Unit Credit										
Discount Rate	8.5% for Union Life and Medical Benefits, and Non-Union Life Insurance Benefits 5.25% for Non-Union Medical Benefits										
Mortality	1983 Group Annuity Mortality Tables for males and females										
Turnover	Table T-3 of the <u>Pension Actuary's Handbook</u> ; <u>Crocker, Sarason and Straight, 1955</u> , as illustrated by the following sample rates: <table> <tr> <th><u>Age</u></th><th><u>Rate</u></th></tr> <tr> <td>20</td><td>5.27%</td></tr> <tr> <td>40</td><td>3.84%</td></tr> <tr> <td>55</td><td>0.33%</td></tr> <tr> <td>65</td><td>0.00%</td></tr> </table>	<u>Age</u>	<u>Rate</u>	20	5.27%	40	3.84%	55	0.33%	65	0.00%
<u>Age</u>	<u>Rate</u>										
20	5.27%										
40	3.84%										
55	0.33%										
65	0.00%										
Retirement	Retirements are assumed to be distributed by age are as follows: <table> <tr> <th><u>Age</u></th><th><u>Rate</u></th></tr> <tr> <td>55-61</td><td>5%</td></tr> <tr> <td>62</td><td>35%</td></tr> <tr> <td>63-65</td><td>10%</td></tr> </table>	<u>Age</u>	<u>Rate</u>	55-61	5%	62	35%	63-65	10%		
<u>Age</u>	<u>Rate</u>										
55-61	5%										
62	35%										
63-65	10%										
Salary Increases	5.0% per year.										
Age of Spouses	Actual age, if reported. Otherwise, wives are assumed to be three years younger than husbands.										

## **Actuarial Basis (cont'd)**

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Eligibility	Age 55 with 20 years of service, age 62 with 5 years of service, or age plus service greater than or equal to 95.
Medical Benefits	<p>The retiree medical plans are fully insured.</p> <p><b>Pennsylvania – Shenango Valley</b></p> <p>The company pays the full medical premium for both Union and Non-union retirees, pre- and post- age 65.</p> <p><b>Pennsylvania – Roaring Creek</b></p> <p>The company pays the full medical premium, including annual increases, for Non-union retirements after 1985 and Union retirements after 1995, until age 65. Thereafter, the company pays \$70/month.</p> <p><b>Ohio – Union Retirees</b></p> <p>Prior to age 62, the company's payment is the equal to the active company subsidy (45% of the full retiree and spouse medical premiums if the retiree had attained 95 points of age and service, otherwise 25% of the medical premiums), with annual increases paid by the retiree. At age 62, the company's payment increases to the full medical premium for the retiree and spouse, with annual increases paid by the retiree. At age 65, the company's payment decreases to \$31.94/month. The spousal coverage stops when the retiree attains age 65.</p> <p><b><u>Grandfathered Arrangements</u></b></p> <p><b>Illinois Kankakee</b></p> <p>For Union retirements prior to 1999, the company pays \$90.02/month for the retiree's coverage regardless of age and the Medicare supplement rate for the spouse. Future annual increases are paid by the retiree. For Union retirements after 1998, spousal coverage is no longer available.</p> <p><b>Pennsylvania – Susquehanna</b></p> <p>For Non-union retirements after 1985 and prior to 1994, the company pays the full uncapped Medicare supplement premium, including annual increases.</p> <p><b><u>All Other Subsidiaries</u></b></p> <p>The cost to the company is limited to the lesser of \$70/month or the individual Medicare supplement premium in effect as of the year of retirement. The amount of the company payment is fixed for the lifetime of the retiree. Spousal coverage is not available.</p>

## Actuarial Basis (cont'd)

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**Medical Trend** Unless subject to the general company cap of \$70/month, Union medical premiums are assumed to increase in future years as follows:

<u>Year</u>	<u>Rate of Increase</u>
1999	6.00%
2000	5.50%
2001+	5.00%

No medical trend is assumed for the non-union benefits.

The monthly premiums applicable to Ohio and Illinois Kankakee Union retirees, i.e. \$31.94/month and \$90.02/month, respectively, are assumed to increase at the rate of 2.00% per year, reflective of anticipated negotiated increases that form the substantive plan.

**Life Insurance  
Benefits** 25% of salary at retirement  
Minimum = \$5,000  
Maximum = \$25,000

**Assets** The market value of assets as of the first day of each fiscal year.

## **Participant Data as of January 1, 1999**

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	<u>Union</u>	<u>Non-Union</u>	<u>Total</u>
1. Counts of Participants included in Valuation			
a. Actives	176	214	390
b. Retirees or beneficiaries of deceased participants	<u>64</u>	<u>87</u>	<u>151</u>
c. Total	240	301	541
2. Averages for Active Participants			
a. Age	45.7	45.2	45.4
b. Service	18.0	14.6	16.1
c. Salary	\$32,624	\$48,252	\$42,553